United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

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75-7203

To be argued by
RONALD H. ALENSTEIN

United States Court of Appeals
FOR THE SECOND CIRCUIT

ROBERT ABRAHAMSON and
MARJORIE ABRAHAMSON,

Plaintiffs-Appellants,

—v.—

MALCOLM K. FLESCHNER, WILLIAM J. BECKER,
HAROLD B. EHRLICH, FLESCHNER BECKER
ASSOCIATES, and HARRY GOODKIN & COMPANY,

Defendants-Appellees.

ON APPEAL FROM AN ORDER OF THE UNITED STATES DISTRICT
COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR APPELLANTS

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON, :

Plaintiffs-Appellants,

-against- : Docket No. 75-7203

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH, LEON POMERANCE, FLESCHNER BECKER ASSOCIATES, and HARRY GOODKIN & COMPANY, :

Defendants-Appellees.

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REPLY BRIEF FOR APPELLANTS

Preliminary Statement

Plaintiffs-appellants Robert and Marjorie Abrahamson ("plaintiffs" or "the Abrahamsons") were limited partners in the defendant investment partnership, Fleschner Becker Associates ("FBA"). They have alleged claims for damages based on violations by defendants-appellees of Rule 10b-5 and Section 206 of the Investment Advisers Act of 1940.

Defendants-appellees ("defendants") urged below, and the District Court held, that plaintiffs had suffered no damages. Defendants pointed out that plaintiffs, over a five-year period, received on account of their investments more than the amounts initially deposited.

Plaintiffs have pointed out that a time came several years after their initial investment when they were induced to enter into an agreement which changed the nature and terms of their investment in many substantial ways. This happened at a time when the value of their investment was far more than the amounts initially deposited. Plaintiffs have therefore urged that they entered into a new "purchase" as of the time of this new agreement, and that their purchase price was the value of the old partnership interests they turned over in exchange for the new partnership interests.* On this view, their damages are the difference between this value and

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* Defendants make much of the fact that the values shown in the financial statements are not at issue (see, e.g., FBA Brief, p. 13). The problem with the financial statements at issue in this case has not been valuation, but <u>liquidity</u>. The fact that huge portions of the portfolio consisted of unregistered securities was concealed. It was precisely because of the concealed liquidity problem that we argued below that the restricted nature of large portions of the portfolio was a material undisclosed fact. See, e.g., Investment Company Act Release No. 7220 (June 9, 1972), pp. 15, 17, 21; Accounting Series Release No. 113, Investment Company Act Release No. 5847 (October 21, 1969).

the price they received on withdrawal.

Defendants have called this an argument based on "constructive purchase," which it is not. They claim that our authorities are inapplicable, and that in any event the modifications were not substantial. We show below that defendants are incorrect.

Plaintiffs have also urged that they are entitled to damages because they were induced to retain their partnership interests by misrepresentations of material fact, with the result that they later sold at a much lower price than that obtainable earlier. See Point II of our main brief.

Defendants say that the recent Supreme Court decision in Blue Chip Stamps v. Manor Drug Stores, 43 U.S.L.W. 4707 (June 9, 1975), bars this claim under Rule 10b-5. The Abrahamsons' claim is based on the Investment Advisers Act, however, as well as Rule 10b-5. The Blue Chip decision deals with the question whether and when a fraud can be said to have taken place "in connection with a purchase or sale" of a security for purposes of Rule 10b-5 liability. But plaintiffs' claim under Section 206 of the Investment Advisers Act does not depend on any "connection with a purchase or sale" of a security, since there is no such language in Section 206. We urge that the defendants here violated a fiduciary duty they owed as investment ad-

visers to the Abrahamsons, who were their clients. We urge that Section 206 was designed to punish precisely the kind of conduct that is involved here. We believe that defendants' contention that plaintiffs suffered no damages ignores the economic realities of the present situation, and ignores the purposes of the Investment Advisers Act and the duties it imposes.

Defendants finally suggest that no private cause of action is afforded by Section 206. They made no such contention below, and raise the point for the first time in their answering brief on this appeal. We show below that the cases in the Southern District of New York, which we believe are the better reasoned cases, are to the contrary.

POINT I

PLAINTIFFS MADE A NEW INVESTMENT IN OR ABOUT 1968, WHEN THEY EXECUTED A SUBSTANTIALLY MODIFIED LIMITED PARTNERSHIP AGREEMENT; ON THIS BASIS, PLAINTIFFS SHOULD BE AWARDED DAMAGES MEASURED BY THE DIFFERENCE BETWEEN THE VALUE THEY GAVE IN RETURN FOR THEIR NEW INTERESTS AND THE VALUE THEY RECEIVED ON DISPOSITION OF THOSE INTERESTS.

Defendants argue that this point is "new," that it is "belated," that it was not foreshadowed in the complaint, and that it is raised "for the first time" on this appeal. See brief for appellees Fleschner, Becker and Fleschner Becker Associates ("FBA Brief"), pp. 33, 34.

The fact is that plaintiffs' claim that a purchase occurred when they signed the substantially modified partnership agreement* is covered by their complaint, and was very clearly set forth in the proceedings below. In their complaint, plaintiffs very clearly alleged that their partnership interests were securities, and that "their investment in and withdrawal from such partnerships constituted purchases and sales of such securities" (9a). They also

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* Defendants have referred to this argument as a "constructive purchase" theory. We do not accept this denomination, which obfuscates the main point of the argument: that when investors agree to exchange their old investment in an enterprise for a new one upon substantially changed terms, a new and independent purchase takes place. We prefer to describe such an event as an actual, not "constructive," purchase, which is consistent with the usage in _Ingenito_ v. _Bermec_, 376 F. Supp. 1154 (S.D.N.Y. 1974) and better reflects the economic realities.

alleged fraudulent conduct "in connection with the purchase and sale of securities" (9a). Clearly, the complaint is not limited to allegations of fraud in the sale of these securities, but also charges fraud in the purchase of them.

Defendants also assert that this theory was never raised until "the cursory reference" in our "reply brief in opposition to defendants' motion..." (FBA Brief, p. 34). In fact, plaintiffs' moving affidavit in support of their own motion for summary judgment pointed to the signing of the new partnership agreement in 1968 (141a, 168a), and stated "This might well be deemed the purchase of a security. We certainly would not have signed the new partnership agreement had we known the facts" (168a).

Plaintiffs' initial memorandum of law in support of their motion for summary judgment also made the argument in the clearest possible way. That passage is reproduced in our main brief, page 30.

Nor can defendants claim any sort of surprise or prejudice. The existence of the 1968 agreement has certainly been known to them for many years. It was defendants themselves who first marked the 1968 agreement as a deposition exhibit. This took place on April 14, 1971. Defendants raised the existence of the 1968 agreement in their Rule 9(g) statement (35a), and made the 1968 agree-

ment an exhibit to the Becker affidavit in support of defendants' motion for summary judgment (36a). Defendants thus had ample notice of the facts, and ample notice of the legal arguments which plaintiffs derive from those facts. Defendants had ample time to respond to those arguments in the court below. They did not urge below that this argument is somehow barred or "belated." Defendants did not claim below that an amendment of the complaint is required, nor do we believe now that one is required. Even if the complaint were somehow technically deficient in its statement of the claim that a purchase occurred when the terms of the investment were changed, summary judgment against a plaintiff would still be improper where it appears that he has a valid claim even though it may be pleaded incorrectly. See Fletcher v. Nostadt, 205 F. 2d 896 (4th Cir. 1953), cert. den. 346 U.S. 877 (1953) (pleadings treated as amended by allegations in affidavit filed in support of motion for summary judgment); see, also, Kuhn v. Civil Aeronautics Board, 183 F. 2d 839, 841 (D.C. Cir. 1950):

> "The whole thrust of modern pleading is towards fulfillment of a notice-giving function and away from the rigid formalism of the common law. It is now generally accepted that there may be no subsequent challenge of issues which are actually litigated, if there has been actual notice and adequate opportunity to cure surprise."

As to the merits of this point, defendants' argument is three-fold. They say that no modification of an investment can be deemed a new purchase unless the changes amount to a major corporate re-structuring similar to the changes involved in a merger with a separate company (see FBA Brief, p. 43). Defendants say that the changes, at the least, must be "adverse" to the investor. Finally, defendants urge that even if the changes need be merely substantial, nevertheless, the changes involved in this case do not meet this standard.

A. <u>If An Investor Is Induced To Enter Into An Agreement Which Substantially Changes The Terms Of His Investment, A New Purchase Occurs; There Is No Requirement That The Changes Be Either "Adverse" or Similar To The Changes Involved In A Merger.</u>

The most critical error in defendants' briefs is the contention that modifications in the terms of the investment which do not have an adverse or detrimental effect do not enter into the question of whether the investor, in weighing the various proposed modifications, is confronted with a significant investment decision. Defendants use this blunt sword to lop off twelve of the sixteen modifications in the 1968 agreement listed on pages

14-15 of the Brief for Appellants. These twelve modifications are described in the FBA Brief (pp. 46-47) as "beneficial" or "neutral" and, therefore, defendants somehow reason, not relevant to the question of whether a significant investment decision was presented.

The FBA Brief, in justifying this wholesale dismissal of most of the 1968 modifications, purports to distill from several cases the "rule" that to merit consideration as part of an "investment decision,"

> ". . . the proposal, if chosen, must have a potentially significant adverse impact on the investor." (FBA Brief, p. 48.)

There is no such "rule," and we have seen no authority to support it.

Defendants say that the premise that only adverse changes are relevant may be found in In Re Penn Central Securities Litigation, 494 F. 2d 528 (3rd Cir. 1974). We are unable to find any language in Penn Central supporting such a premise. Defendants also suggest that Ingenito v. Bermec Corp., 376 F. Supp. 1154 (S.D. N.Y. 1974), supports this "rule." Actually, the Court in Ingenito held (p. 1182) that a purchase or sale is adequately alleged when

> ". . . there is alleged a substantial modification of an investment contract creating fresh rights and obligations of the parties

> and the investor gives some consideration, either a promise of future payments or the relinquishment of a significant right."

If a "substantial modification" is one "creating fresh rights and obligations of the parties," certainly changes other than "adverse" changes must be considered. That this was the view of the Ingenito Court appears even more clearly in another passage, wherein the Court stated (p. 1181) that the authorities support the proposition that

> ". . . a purchase or sale arises when the nature and terms of an investor's involvement in a business enterprise are substantially altered by the creation of new rights or obligations." (Emphasis added.)

Plainly, the "obligations" referred to are those of the investor. But the "new rights" referred to are also those of the investor. Thus, "new rights," which are beneficial changes, as well as "obligations," which are adverse changes, are relevant, under Ingenito, in determining what constitutes a substantial modification equivalent to a new purchase.

It is noteworthy that the Court in Ingenito set forth the above test in apparent response to the argument of the defendants there that the modification at issue had a major beneficial impact. The modification there involved

an extension of time for the plaintiffs to pay on their promissory notes; the defendants referred to this as a "welcome break" (p. 1178). The Court said, "The arguments are not persuasive" (p. 1178).

We recognize that the Ingenito test also calls for some consideration to be parted with by the investor. Defendants themselves concede that four of the modifications involved here were detrimental to investors. These factors (e.g., provision for a substantial salary for the managing partners; elimination of quarterly draw for the limited partners) surely constitute consideration under the Ingenito test. Moreover, there is the inescapable fact that plaintiffs, in agreeing to the modifications, turned over to the newly constituted partnership the value of their interests in the old partnership. This value was well over $1,000,000. Had they chosen not to agree, their participation would have ended, and they would have received the value of their interests.

Moreover, as the Ingenito Court in a footnote observed, this Court's holding in International Controls Corp. v. Vesco, 490 F. 2d 1334 (2d Cir. 1974), may eliminate entirely the need to find any consideration parted with by the investor, in order to find a purchase for purposes of Rule 10b-5. There, this Court found a "sale"

for Rule 10b-5 purposes in a gratuitous transfer of portfolio stock from a corporation to its shareholders as a dividend, holding (p. 1346),

> "We therefore reject our dissenting brother's paean to literalness in construing the term 'sale' to require the passage of consideration in order to inject the requisite significance into the disposition of securities. Learned Hand wisely counselled:
>
> > 'Of course it is true that the words used, even in their literal sense, are the primary, and ordinarily the most reliable, source of interpreting the meaning of any writing: be it a statute, a contract, or anything else. But it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning.'
>
> Cabell v. Markham, 148 F. 2d 737, 739 (2d Cir. 1945). Accordingly, although in other contexts the term 'sale' might appropriately be construed more narrowly, <u>we find a rote emphasis on consideration inconsistent with the broad scope of protection under §10(b) for those who engage in transactions eventuating in the acquisition or disposition of securities</u>." (Emphasis added.)

The holding of <u>International Controls</u> that consideration is unnecessary to a sale for purposes of Rule 10b-5 would seem to imply that detriment to an investor is similarly unnecessary to a purchase. The point that both good and bad features of a proposed securities transaction are

pertinent to a investor is made even more clearly, however, in another passage of the decision. The Court suggested how the corporate seller may have weighed the pros and cons of its decision, stating (p. 1345),

> "The decision whether to retain or spin-off a subsidiary is indeed an important one for the parent corporation. The possible asset drain must be weighed against such considerations as the desirability of removing the blight of an unprofitable subsidiary. . . . In any event, it is a transaction . . . well deserving of and entitled to the protection of §10(b)."

* * *

We also consider ill-founded defendants' position that modifications, however substantial in their potential economic impact, cannot amount to a purchase-or-sale decision if the changes can be characterized as "internal corporate restructuring." For this proposition, defendants cite <u>In Re Penn Central Securities Litigation</u>, 494 F. 2d 528 (3rd Cir. 1974). There, the Court held that a single major modification, a conversion of railroad company shares into holding company shares enabling the corporation to diversify into non-railroad activities, did not amount to a purchase or sale, since this constituted mere internal reordering, not involving any change of ownership of assets such as a merger would produce.

<u>Penn Central</u> is factually distinguishable from the

case at bar on several grounds. First, the present case involves many substantial modifications rather than just one. No less importantly, the present case does not involve freely transferable corporate stock accompanied by the customary right to vote for changes in management and corporate structure. Rather, it involves limited partnership interests which were not freely transferable, which could be surrendered only at the end of a fiscal year, and which carried no voice whatever in the management of the enterprise. In this context, the merely procedural may become vital.

In any event, and whatever the impact of Penn Central on Third Circuit courts may be, its apparent holding that a change involving "internal restructuring" cannot be a purchase or sale of a security cannot be said to be the law in the Second Circuit. Such a holding is irreconcilable with SEC v. Associated Gas & Electric Co., 99 F. 2d 795 (2d Cir. 1938); International Controls v. Vesco, supra, 490 F. 2d 1334 (2d Cir. 1974); and Ingenito v. Bermec, supra, 376 F. Supp. 1154 (S.D. N.Y. 1974). The transactions in all of these cases involved an "internal restructuring" in which the purchaser did not exchange his interest in particular assets for an interest in different assets, but "merely" agreed to a modification of a substantial nature in the terms or form of his interest. Nonetheless, the

Courts in each case found that a purchase or sale within the broad meaning of Rule 10b-5 took place.*

At pages 17-26 of our main brief, we have discussed a series of cases which we think support the proposition we espouse, the proposition that a substantial modification of the terms of an investment may produce a new purchase for purposes of Rule 10b-5. Defendants say that all but one of these cases were decided under different statutes, and are therefore irrelevant. The Court in Ingenito v. Bermec, supra, which is a 10b-5 case, did not think so, and relied upon many of these cases in explaining its reasoning. Defendants say that the word "purchase" may have a meaning for purposes of Rule 10b-5 which is different from its meaning under other laws, citing SEC v. National Securities, Inc. 393 U.S. 453 (1969). What National Securities actually held was that "purchase" may have a broader meaning for purposes of Rule 10b-5 than it has under other laws. In National Securities, the defendants urged that Rule 10b-5 did not apply to an exchange of shares in the course of a merger, pointing out that a purchase does not include a

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* Any test involving an examination of whether ownership of assets had changed would border on meaninglessness in such a case as the present one, wherein the security involved is a limited partnership interest in an investment partnership. In such an organization, the assets are constantly changing. This does not, we urge, concern the investor nearly so much as the terms by which his investment is governed.

merger for purposes of certain other laws. The Supreme Court held (p. 467)

> "The broad antifraud purposes of the statute and the rule would clearly be furthered by their application to this type of situation."

Defendants finally assert that "common sense" supports their proposed rule. With respect, we think it frivolous to suggest that an investor considers only burdens, not benefits, in making an investment decision. We think it is frivolous to suggest that changes in the terms of a limited partner's investment can never be significant enough to call for an investment decision unless they involve something akin to a merger.

We respectfully submit that the Ingenito test, which is derived from earlier cases decided by this Court, is the proper test, and is far more desirable because it eschews artificiality and rote literalism in favor of a flexible approach to the facts presented.

B. The Modifications In The 1968 Agreement Were Clearly Of Sufficient Significance And Scope To Amount To A New Purchase.

In our main brief, we presented a list of sixteen of the comprehensive changes in the 1968 agreement (pp. 14-17) and urged their significance. There is no need to re-

iterate that argument here. We think that an examination of the list and comparison of the old and new agreements (66a and 87a) reveals a major overhaul of the investment contract that amounts, as a matter of law, to a new purchase within the meaning of Rule 10b-5.

One point that perhaps merits re-emphasis is the volume as well as individual significance of the modifications. Defendants have attempted to deal with the changes one by one, but have overlooked their cumulative impact.

As above stated, we contend that the changes here amount, as a matter of law, to a new purchase within the meaning of Rule 10b-5. Certainly they cannot be said to be insignificant as a matter of law. Yet that is what defendants urge. If the Court should not agree with us that the modifications here produced a purchase as a matter of law, then we respectfully suggest that at the least an issue of material fact is presented, requiring a trial.

C. Damages Based On The Difference Between The Value Plaintiffs Paid For Their New Interests In 1968 And The Value Received On Disposition Of Those Interests Should Be Awarded.

Defendants repeatedly point out that Ingenito v. Bermec, supra, did not involve any question of damages.

There is no denying that Ingenito did involve a determination that substantial modifications of an investment contract may result in a new purchase of a security. If that is so, then surely the consideration given by the investor at the time of such purchase is his purchase price.

Here, as we have pointed out in our main brief (p. 31), plaintiffs transferred to the newly constituted partnership in return for their new interests, assets having a value far in excess of the amount initially deposited by plaintiffs. On disposition of their interests, plaintiffs received far less than the value of what they had transferred. They should be awarded damages representing the difference. See Chasins v. Smith, Barney & Co., 437 F. 2d 1167, 1173 (2d Cir. 1970); Kramer v. Scientific Control Corp., 365 F. Supp. 780, 790 (E.D. Pa. 1973); Sarlie v. E.L. Bruce Co., 265 F. Supp. 371, 376 (S.D. N.Y. 1967).

POINT II

PLAINTIFFS HAVE A PRIVATE RIGHT OF ACTION UNDER THE INVESTMENT ADVISERS ACT OF 1940 AND ARE ENTITLED TO DAMAGES THEREUNDER.

Defendants in their briefs have raised for the first time in this proceeding the argument that no private damage action may be implied under Section 206 of the Investment Advisers Act of 1940. Defendants rely upon two District Court cases, one in California and one in Florida. These are Gammage v. Roberts, Scott & Co., [Current] CCH Fed. Sec. L. Rep. ¶ 94,761 (S.D. Cal. 1974) (Turrentine, J.); Greenspan v. Eugene Campos Del Toro, 73-638-Civ. (S.D. Fla., May 17, 1974) (Eaton, J; unreported opinion).

The leading case on the question in this jurisdiction, however, is Bolger v. Laventhol Krekstein Horwath & Horwath, CCH Fed. Sec. L. Rep. ¶ 94,618 (S.D. N.Y. 1974). In Bolger, Judge Metzner held that limited partners of an investment partnership "fall squarely within the class of persons whom the antifraud provisions of Section 206 were intended to protect" (p. 96,189). Holding that the limited partners thus had "standing to seek redress" (p. 96,189), the Court held (p. 96,190),

> "Moreover, a private right of action for damages in these circumstances is an appropriate vehicle for effectuating Congress' intent in affording protection to these investors."

Subsequently, the defendants in Bolger sought rehearing on the ground of the Greenspan decision. On rehearing, Judge Metzner declined to follow Greenspan. Bolger v. Laventhol Krekstein Horwath & Horwath, CCH Fed. Sec. L. Rep. ¶ 94,739 (S.D. N.Y. 1974) ("Bolger II"). The Gammage and Greenspan decisions have also been rejected in favor of the Bolger view by Judge Wyatt in Jones v. Equitable Life Assurance Society, CCH Fed. Sec. L. Rep. ¶ 94,986 (S.D. N.Y. 1975).

It is significant that the reasoning of Gammage, a case decided in the Southern District of California, has also been rejected as recently as June of this year by Judge Williams of the Northern District of California. In Angelakis v. Churchill Management Corp., CCH Fed. Sec. L. Rep. ¶ 95,285 (N.D. Cal. 1975), Judge Williams said (p. 98,464),

> "It is the opinion of this court that the reasoning of Bolger is more persuasive than that of Gammage."

It is evident that the reasoning of Bolger has now become the majority view.

We agree with the analysis in Lybecker, "Advisers Act Developments," 8 Review of Securities Regulation 927, 934 (April 23, 1975):

"... [T]he Bolger case is the best-reasoned of the three. Where the federal securities laws prohibit certain types of conduct or imply a fiduciary relationship, a private right of action in favor of the protected party is both a necessary and appropriate supplement to direct enforcement of the statutory provisions. The decisions in Greenspan or Gammage do not reflect careful consideration of the policy arguments for implying a private right of action, and their hyper-technical reasoning is unlikely to make them persuasive precedents in future cases."

It may be further observed that Blue Chip Stamps v. Manor Drug Stores, 43 U.S.L.W. 4707, supra, does not in any way affect plaintiffs' claim for damages under the Advisers Act since Congress did not insert an "in connection with a purchase or sale" requirement in Section 206. That section proscribes, inter alia, any act, practice, or course of business by an adviser which "is fraudulent, deceptive, or manipulative" or which operates as a fraud or deceit upon any client..." The protection to the investor is of a continuous nature. It is not keyed to any limited phase or event such as a purchase or sale transaction. Rather, the duties of fair dealing and full disclosure it imposes on the adviser are co-extensive with the duration of the adviser-client relationship.

We urge that this duty of defendants* was at no

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* Defendants Fleschner, Becker, and Ehrlich, who were general partners in FBA, are "investment advisers" and liable as such under Section 206. The other defendants, we submit, are liable as aiders and abetters. See Bolger II, supra.

time greater than when the limited partners were asked to execute a substantially modified investment agreement in October, 1968. At this point, FBA's portfolio was largely composed of unregistered stock—a fact of which plaintiffs should have been advised. Had they been so advised, plaintiffs would have withdrawn from FBA at that time rather than sign an agreement changing their investment and locking their funds in FBA for an additional year. If there was ever a time for disclosure by these fiduciaries, it was at the time when they were seeking substantial changes in the advisory contract.

It should be noted that this argument does not depend upon any finding that the changes sought were sufficient to constitute the transaction a new purchase. Section 206 does not require any purchase. We respectfully suggest that the duty to disclose is imposed by the adviser-client fiduciary relationship, and exists throughout the relationship. The presentation of a document by which the defendants sought to change the relationship was certainly an event of importance to the relationship. If any particular event is required to trigger the duty of an adviser to disclose, and this we doubt, certainly a proposed change in the advisory contract would suffice <u>regardless</u> of whether the new contract would constitute a new security.

* * *

Defendants argue, and Judge Carter found below, that the measure of damages under Section 206 is no different from the measure under Rule 10b-5, assuming a private right of action exists. Defendants say that no damages are recoverable under Rule 10b-5 and therefore none are available under Section 206.

We have shown in Point I above that plaintiffs are entitled to damages under Rule 10b-5. Even if they are not, we believe that damages under Section 206 are recoverable. Like Rule 10b-5, Section 206 prohibits fraud and deception and acts which operate as a fraud or deceit. Unlike Rule 10b-5, as we have urged above, Section 206 guarantees the integrity of a relationship rather than an event. Therefore, if there has been a course of conduct by an adviser during the relationship which has injured the client or has "operated" as a fraud or deceit upon the client, damages should be recoverable.

Here, the advisers managed funds of their beneficiaries and, for a time, apparently caused these funds to grow. This growth, by accounting entry, was transferred to limited partners in the form of accretions to their capital accounts. It became their property. The advisers reported this growth at regular intervals. But they concealed the fact that the funds and property were being

placed into investments suffering from a serious lack of liquidity. While concealing this fact, they sought concessions in the form of a change in the relationship, a changed agreement, from their beneficiaries. Had the beneficiaries refused, the relationship would have terminated, and the beneficiaries would have had their property returned to them, including accretions.

We think the damages are clear, and should be measured from this occasion of breach of duty.

If an investment adviser commits a fraud upon a client with whom a long-standing relationship exists and with respect to an investment which, over a number of years, has enjoyed substantial growth, we do not think that the investor should be deprived of a remedy for losses resulting from the fraud. Nor should the adviser be insulated from liability, merely because such losses may not consume the entire growth the investor had earned over the years. If a rule based on the initial deposit and eventual withdrawal prices were applied in this situation regardless of the duration of the relationship, or if the losses suffered by such an investor were dismissed as "paper losses" and hence damnum absque injuria, we submit that the remedial purposes of the Act would be hamstrung, one class of wrongdoers would arbitrarily escape liability, and a substantial injustice would be done to the injured investor.

CONCLUSION

For the foregoing reasons and the reasons expressed in our main brief, the order and judgment of the District Court granting defendants' motions for summary judgment dismissing the complaint should be reversed and the case remanded for further proceedings.

Respectfully submitted,

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